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financial
statements, June
30, 1992

MONTANA STATE LOTTERY
AUDITED FINANCIAL STATEMENTS
JUNE 30, 1992

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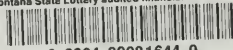
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MONTANA STATE LOTTERY
AUDITED FINANCIAL STATEMENTS
JUNE 30, 1992

TABLE OF CONTENTS

	<u>Page</u>
OFFICE OF THE LEGISLATIVE AUDITOR LETTER	3
COMMISSION MEMBERS AND ADMINISTRATIVE OFFICIALS	4
INTRODUCTION AND BACKGROUND	5
INDEPENDENT AUDITOR'S REPORT	6
BALANCE SHEETS AS OF JUNE 30, 1992 AND 1991	7
STATEMENTS OF REVENUE, EXPENSE AND CHANGES IN RETAINED EARNINGS FOR FISCAL YEARS ENDED JUNE 30, 1992 AND 1991	8
STATEMENTS OF CASH FLOWS FOR THE FISCAL YEARS ENDING JUNE 30, 1992 AND 1991	9
NOTES TO FINANCIAL STATEMENTS	10-15
INDEPENDENT AUDITOR'S REPORT ON COMPLIANCE WITH LAWS AND REGULATIONS BASED ON THE AUDIT OF MONTANA STATE LOTTERY FINANCIAL STATEMENTS PERFORMED IN ACCORDANCE WITH <u>GOVERNMENT AUDITING STANDARDS</u>	16
COMPLIANCE FINDING JUNE 30, 1992	17
INDEPENDENT AUDITOR'S REPORT ON INTERNAL CONTROL STRUCTURE RELATED MATTERS NOTED IN THE MONTANA STATE LOTTERY FINANCIAL STATEMENT AUDIT CONDUCTED IN ACCORDANCE WITH <u>GOVERNMENT AUDITING STANDARDS</u>	18-19
CURRENT YEAR REPORTABLE CONDITION JUNE 30, 1992	20
STATUS OF PRIOR AUDIT REPORTABLE CONDITIONS AND RECOMMENDATIONS JUNE 30, 1992	21



STATE OF MONTANA
Office of the Legislative Auditor

STATE CAPITOL
HELENA, MONTANA 59620
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DEPUTY LEGISLATIVE AUDITORS:

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Operations and EDP Audit

JAMES GILLET
Financial-Compliance Audit

JIM PELLEGRINI
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LEGISLATIVE AUDITOR:
SCOTT A. SEACAT
LEGAL COUNSEL:
JOHN W. NORTHEY

September 1992

The Legislative Audit Committee
of the Montana State Legislature:

Enclosed is the report on the audit of the Montana State Lottery
for the year ended June 30, 1992.

The audit was conducted by Douglas Wilson & Company, PC, under a
contract between the firm and our office. The comments and
recommendations contained in this report represent the views of the
firm and not necessarily the Legislative Auditor.

The agency's written response to the report recommendations is
included in the back of the audit report.

Respectfully submitted,

A handwritten signature in black ink, appearing to read "Scott A. Seacat", written over a horizontal line.

Scott A. Seacat
Legislative Auditor

MONTANA STATE LOTTERY
COMMISSION MEMBERS AND ADMINISTRATIVE OFFICIALS
JUNE 30, 1992

Commission Members

Ward Shanahan - Chairman

Rebecca Erickson

William Ware

David Kasten

Dwaine Iverson

Residence

Helena

Glasgow

Helena

Brockway

Shelby

Administrative Officials

Sandra Guedes, Director

L. John Onstad, Security

Gerald J. LaChere, Operations

Janet Drexel Bone, Marketing

MONTANA STATE LOTTERY
INTRODUCTION AND BACKGROUND

JUNE 30, 1992

INTRODUCTION

We performed a financial compliance audit of the Montana State Lottery for the fiscal year ended June 30, 1992, and issued an opinion on such. The scope of our services is defined in our contract with the Office of Legislative Auditor, as supplemented by certain requirements included in the bidder's information.

As a result of our audit, we have issued an independent auditor's report on compliance with laws and regulations and internal control structure related matters which includes certain required comments.

BACKGROUND

The Montana State Lottery was created in November 1986 by a referendum vote of the people of Montana. The "Montana State Lottery Act of 1985" appears as Chapter 669 of the Montana Session Laws and Title 23, Chapter 7, of the Montana Code Annotated. The general purpose is to allow lottery games in which the players purchase from the state, through the administration of the Montana State Lottery, a chance to win a prize. Disposition of revenue is a minimum of 45 percent for prizes, a maximum of 10 percent for commissions to sales agents, payment of operating expenses, and the remaining revenue to the Office of Public Instruction/School Equalization Account (hereinafter referred to as "OPI") and Board of Crime Control.

**Certified
Public
Accountants**

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Bruce H. Gaare, CPA

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Commissioners
Montana State Lottery
Helena, Montana

INDEPENDENT AUDITOR'S REPORT

We have audited the balance sheets of the Montana State Lottery, a component unit of the State of Montana as of June 30, 1992 and 1991, and the related statements of revenue, expense and changes in retained earnings, and cash flows for the years then ended. These financial statements are the responsibility of the Lottery's management. Our responsibility is to express an opinion on these financial statements based on our audit.

We conducted our audit in accordance with generally accepted auditing standards. Those standards require that we plan and perform the audit to obtain reasonable assurance about whether the financial statements are free of material misstatement. An audit includes examining, on a test basis, evidence supporting the amounts and disclosures in the financial statements. An audit also includes assessing the accounting principles used and significant estimates made by management, as well as evaluating the overall financial statement presentation. We believe that our audit provides a reasonable basis for our opinion.

In our opinion, the financial statements referred to above present fairly, in all material respects, the financial position of the Montana State Lottery as of June 30, 1992 and 1991, and the results of its operations and its cash flows for the years then ended in conformity with generally accepted accounting principles.

Douglas Wilson & Company, P.C.

September 11, 1992

**Douglas Wilson
&
Company, PC**

Established 1913

MONTANA STATE LOTTERY

BALANCE SHEETS AS OF JUNE 30, 1992 AND 1991

	6/30/92	6/30/91
ASSETS		
Current Assets:		
Cash and Cash Equivalents	\$ 1,447,158	\$ 975,605
Accounts Receivable	661,160	602,632
Inventory	140,671	173,921
Interest Receivable	4,918	--
Prepaid Expenses	1,717	8,088
Employee Advances	5,000	5,000
	<u>2,260,624</u>	<u>1,765,246</u>
Fixed Assets:		
Computer, Furniture and Equipment	706,407	762,715
Computer Software	772,665	840,400
	<u>1,479,072</u>	<u>1,603,115</u>
Less: Accumulated Depreciation and Amortization	<u>(1,247,491)</u>	<u>(1,091,024)</u>
	<u>231,581</u>	<u>512,091</u>
Other Assets:		
Multi-State Lottery Receivable	571,823	542,809
Advertising License Fee, Net of Accumulated Amortization of \$52,124 in 1992 and \$30,261 in 1991	--	21,863
	<u>571,823</u>	<u>564,672</u>
	<u>\$ 3,064,028</u>	<u>\$ 2,842,009</u>
LIABILITIES AND FUND EQUITY		
Current Liabilities:		
Long-Term Debt Due Within One Year	\$ --	\$ 70,033
Accounts Payable and Accruals	417,829	340,871
Due to OPI	1,237,357	1,092,397
Due to Other State Agencies	123,070	97,048
Accrued Compensated Absences	126,424	99,549
Estimated Prizes Payable	1,029,071	994,758
Deferred On-line Revenue	104,000	19,629
Allowance for Ticket Returns	24,917	129,751
	<u>3,062,668</u>	<u>2,844,036</u>
Fund Equity (Deficit):		
Contributed Capital	1,360	--
Unreserved Retained Earnings (Deficit)	--	(2,027)
	<u>\$ 3,064,028</u>	<u>\$ 2,842,009</u>

See the accompanying notes to the financial statements.

MONTANA STATE LOTTERY

STATEMENTS OF REVENUE, EXPENSE AND CHANGES IN RETAINED EARNINGS
FOR FISCAL YEARS ENDING JUNE 30, 1992 AND 1991

	6/30/92	6/30/91
Operating Gross Revenues:		
Instant Ticket Games	\$ 9,248,920	\$ 8,170,377
On-Line Games	<u>18,673,019</u>	<u>15,761,001</u>
Gross Ticket Revenues	<u>27,921,939</u>	<u>23,931,378</u>
Cost of Ticket Revenues:		
Instant Ticket Prize Expense	5,094,809	4,672,276
On-Line Ticket Prize Expense	8,456,198	6,986,546
Retailer Commission	1,609,178	1,346,955
Cost of Tickets Sold	479,346	503,516
On-Line Vendor Fees	<u>3,741,750</u>	<u>3,539,506</u>
Total Cost of Ticket Revenues	<u>19,381,281</u>	<u>17,048,799</u>
Net Ticket Revenues	8,540,658	6,882,579
License Fees	<u>4,350</u>	<u>4,350</u>
Net Operating Revenue	<u>8,545,008</u>	<u>6,886,929</u>
Operating Expenses:		
Advertising	669,472	622,030
Amortization	120,456	198,341
Bad Debt	4,760	668
Communications	75,121	73,970
Contractual Services	527,062	368,274
Depreciation	116,716	119,055
Management Service Fee	94,740	78,627
Multi-State Operating Fees	44,268	33,807
Personal Services	1,114,772	966,940
Repairs and Maintenance	77,085	77,878
Supplies and Materials	48,256	46,326
Utilities and Rent	95,165	96,536
Travel	40,003	35,054
Other	<u>20,996</u>	<u>21,245</u>
Total Operating Expenses	<u>3,048,872</u>	<u>2,738,751</u>
Net Operating Income Before Non-Operating Revenues, Expenses and Transfers	<u>5,496,136</u>	<u>4,148,178</u>
Non-Operating Revenues (Expenses):		
Interest Earnings	95,184	40,371
Gain (Loss) on Sale of Assets	(6,459)	2,927
Other	--	6,953
Interest Expense	--	(119)
Total Non-Operating Revenue (Expenses)	<u>88,725</u>	<u>50,132</u>
Net Operating Income Before Transfers	5,584,861	4,198,310
Operating Transfers:		
OPI	5,493,509	4,200,337
Board of Crime Control	<u>89,325</u>	<u>--</u>
Net Income (Loss)	2,027	(2,027)
Retained Earnings, Beginning of Period	<u>(2,027)</u>	<u>--</u>
Retained Earnings, End of Period	\$ <u>--</u>	\$ <u>(2,027)</u>

See the accompanying notes to the financial statements.

MONTANA STATE LOTTERY

STATEMENTS OF CASH FLOWS
FOR THE FISCAL YEARS ENDING JUNE 30, 1992 AND 1991

	<u>6/30/92</u>	<u>6/30/91</u>
Cash Flows from Operating Activities:		
Net Operating Income Before Non-Operating Expense and Transfers	\$ 5,496,136	\$ 4,148,178
Adjustment to Reconcile Net Operating Income to Net Cash Provided by Operating Activities:		
Amortization and Depreciation	237,172	317,396
Book Value of Assets Disposed	--	773
Decrease (Increase) In:		
Accounts Receivable	(58,528)	169,358
Inventory	33,250	(65,465)
Interest Receivable	(4,918)	--
Prepaid Expenses	6,371	(6,160)
Employee Advances	--	940
Multi-State Lottery Receivable	(29,014)	(542,809)
Increase (Decrease) In:		
Accounts Payable and Accruals	76,958	11,345
Due to OPI	144,960	(427,123)
Due to Other State Agencies	26,022	20,618
Accrued Compensated Absences	26,875	5,157
Estimated Prizes Payable	34,313	299,614
Deferred On-Line Revenue	84,371	(400)
Allowance for Returned Tickets	(104,834)	(18,142)
	<u>5,969,134</u>	<u>3,913,280</u>
Cash Flows from Non-Capital Financing Activities:		
Operating Transfers Out:		
OPI	(5,493,509)	(4,200,337)
Board of Crime Control	(89,325)	--
	<u>(5,582,834)</u>	<u>(4,200,337)</u>
Cash Flows from Capital and Related Financing Activities:		
Payment of Long-Term Debt	--	(95,251)
Interest Paid on Fixed Assets Acquisition Contract	--	(119)
Other	--	6,953
Acquisition of Fixed Assets and Intangible Assets	(25,800)	(48,317)
Proceeds from Sale of Fixed Assets	15,870	17,790
	<u>(9,930)</u>	<u>(118,944)</u>
Cash Flows from Investing Activities:		
Interest Earned on Cash Equivalents	<u>95,183</u>	<u>40,371</u>
Net Increase (Decrease) In Cash and Cash Equivalents	471,553	(365,630)
Cash and Cash Equivalents at Beginning of Year	<u>975,605</u>	<u>1,341,235</u>
Cash and Cash Equivalents at End of Year	<u>\$ 1,447,158</u>	<u>\$ 975,605</u>

See the accompanying notes to the financial statements.

MONTANA STATE LOTTERY

NOTES TO FINANCIAL STATEMENTS
JUNE 30, 1992 AND 1991

Note 1: Summary of Significant Accounting Policies:

- A. **Organization** - The Montana State Lottery was created in November 1986 by a referendum vote of the people of Montana. Section 23-7-101, Montana Code Annotated (MCA) establishes the provision of the code under which the Montana State Lottery operates. The Montana Lottery is operated by a five member commission consisting of Montana residents appointed by the Governor. The Commission, by law, has the power to operate a state lottery, determine the types and forms of lottery games, set the ticket price, number and size of prizes, conduct lottery drawings, enter into agreements to offer lottery games with other lottery states and prepare financial reports.

Disposition of revenue is a minimum of 45 percent for prizes, a maximum of 10 percent for commissions to sales agents, payment of operating expenses and the remaining revenue to the OPI and the Board of Crime Control.

The State of Montana provides certain services to the Lottery covering: central payroll, accounting, self-insurance, communication, motor pool and various other services. The costs charged to the Lottery for these services were approximately \$1,410,000 and \$1,320,000 in fiscal years ended June 30, 1992, and 1991, respectively.

- B. **Reporting Entity** - The Lottery, a division within the Montana Department of Commerce, is considered a component unit of the oversight unit known as the State of Montana. There are no component units to be included with the Lottery as a reporting agency.
- C. **Basis of Accounting** - The Lottery utilizes the accrual basis of accounting and is classified as an enterprise fund of the governmental proprietary fund type. Enterprise funds account for operations: a) financed and operated similar to private business enterprises, where the intent of the Legislature is that costs are to be financed or recovered primarily through user charges, or b) where the Legislature has decided that periodic determination of revenue earned, expenses incurred or net income is appropriate.
- D. **Revenue Recognition** - Sales of lottery instant tickets are made to licensed retailers, who in turn sell the tickets to the public. Retailers receive a minimum 5 percent commission. Revenue is recognized when the tickets are delivered to the retailers. Tickets not sold by the retailer may be returned to the Lottery for credit. Sales are reduced for estimated ticket returns.

Sales of on-line lottery tickets, starting in early November 1989, are made by licensed retailers to the public with the use of computerized terminals. Retailers receive a 5 percent commission. Revenue is recognized on drawing dates. Tickets sold in advance for future drawing are recorded as deferred revenue until the ticket becomes valid for a drawing.

- E. **Prizes** - Prize expense is recognized based on the predetermined prize structure for each instant ticket and on-line game. Free tickets are recorded as a reduction in revenue and not as prize expense.
- F. **Cash and Cash Equivalents** - Cash and cash equivalents consist of interest-bearing deposits with the Montana Board of Investments in the State's short-term investment pool and cash on deposit with the State Treasurer which is part of the State's pooled cash and is not separately identifiable as to specific types of securities. These funds are highly liquid and may be drawn on daily. See the statewide audit for the level of risk associated with the cash and cash equivalents.

Cash is as follows:

	<u>6/30/92</u>	<u>6/30/91</u>
Cash on Deposit with State Treasurer	\$ 29,808	\$ 564,655
Cash on Deposit in Short-Term Investment Pool	1,407,200	400,800
Cash in Revolving Check Account	10,000	10,000
Petty Cash	150	150
	<u>\$ 1,447,158</u>	<u>\$ 975,605</u>

- G. **Inventory** - Inventories consist of tickets and supplies. Ticket inventory includes lottery instant tickets stored in the warehouse and with marketing representatives. The tickets are carried at cost using the specific identification method. Tickets are charged to cost of sales when sold and unsold tickets are charged to cost of sales upon the end or cancellation of a game.

Supply inventory is carried at cost and expensed as used.

- H. **Fixed Assets** - Fixed assets are recorded at cost and depreciation or amortization is computed using the straight-line basis over the following estimated useful lives:

Computer	6 years
Software	5 years
Vehicles	3 years
Furniture and equipment	6 - 10 years

- I. **Advertising License Fee** - Advertising license fee is recorded at cost and amortization is computed using the straight-line basis over a 3-year estimated useful life.
- J. **Accounts Receivable** - Accounts receivable represent amounts due the Lottery for purchased tickets. These amounts are electronically transferred within 28 to 34 days of instant tickets purchased, and weekly for on-line tickets purchased. The Lottery grants credit to licensed retailers throughout the State of Montana. An allowance for uncollectible accounts is computed based on historical experience. The allowance for doubtful accounts was \$985 and \$0, respectively, at June 30, 1992 and 1991.
- K. **Compensated Absences** - State employees earn vacation leave ranging from 15 to 24 days per year depending on the individual's years of service. Vacation leave may be accumulated to not exceed 2 times the maximum annual leave. Sick leave is earned at 12 days a year with no maximum accumulation. Upon retirement or termination, an employee is paid 100 percent for unused vacation and 25 percent for unused sick leave.

- L. **Joint Venture - Multi-State Lottery Association** - In November 1989, the Montana State Lottery joined the Multi-State Lottery Association (MUSL). MUSL was created in September 1987 to operate a multi-state lottery game for the benefit of party lotteries. Each lottery participating in MUSL is represented on the Board of Directors. The Board's responsibilities are to initiate, promulgate, and administer a multi-state lottery game for the mutual benefit of the member lotteries.

As of June 30, 1992, MUSL's unaudited financial information is as follows:

Total Assets	<u>\$ 352,471,846</u>
Total Liabilities	\$ 352,194,457
Fund Balance	<u>277,389</u>
Total Liabilities and Fund Balance	<u>\$ 352,471,846</u>
Total Revenue	\$ 2,240,279
Total Expenses	<u>2,061,060</u>
Excess (Deficit) of Revenue Over Expenses	<u>\$ 179,219</u>

Note 2: Long-Term Debt - Long term debt consist of the following:

	<u>6/30/92</u>	<u>6/30/91</u>
Installment purchase of Instant Lottery System software payable in monthly payments of \$11,672 including no interest through March 1990 and \$23,344 including no interest through February 1991.	\$ --	\$ 70,033
	--	<u>70,033</u>
Less portion due within one year	--	<u>70,033</u>
Long-term portion	\$ --	\$ --

Note 3: Obligation to Transfer Funds to OPI -

The remaining portion of gross revenue not used for payment of prizes, commissions, and operating expenses is transferred quarterly from the Lottery to the OPI. At June 30, 1992 and 1991, \$1,237,357 and \$1,092,397, respectively, were payable to the OPI. Operating transfers of \$5,493,509 and \$4,200,337 were reported during the fiscal years ended June 30, 1992 and 1991, respectively.

Note 4: Lease Commitments - The Lottery has a lease for office and warehouse space in Helena, Montana. Lease expense included in the operating expenses is \$80,400 and \$81,600 for the fiscal years ended June 30, 1992 and 1991, respectively. Minimum future lease payments, under all non-cancellable leases, are \$78,000 per year through 1997.

Note 5: Employee Retirement System - The Lottery and its employees make contributions to the Montana Public Employees Retirement System (PERS) defined benefit plan. The Lottery is required to contribute for full-time employees at the rate of 6.417 percent of annual compensation under state statute. Employees are

required to contribute 6.30 percent of annual compensation. Part-time employees have an option to belong to the retirement plan, depending upon hours worked. The Montana Public Employees' Retirement System does not segregate financial information for each participating entity.

The total number of Lottery employees covered during the years ended June 30, 1992 and 1991 was 35 and 36, respectively. The total payroll for the employees was \$856,513 in 1992, and \$782,269 in 1991. The Lottery's contributions were \$56,106 and \$50,093 for the years ended June 30, 1992, and 1991, respectively. Benefit eligibility is age 60 with at least 5 years of service; age 65 regardless of service; or 30 years of service regardless of age. Actuarially reduced benefits may be taken with 25 years of service or at age 50 with at least 5 years of service. Monthly retirement benefits are determined by taking 1/56 times the number of years of service times the final average salary. Members' rights become vested after 5 years of service.

The "pension benefit obligation" is a standardized disclosure measure of the present value of pension benefits, adjusted for the effects of projected salary increases, estimated to be payable in the future as a result of employee service to date. The measure, which is the actuarial present value of credited projected benefits, is intended to help users assess the system's funding status on a going-concern basis, assess progress made in accumulating sufficient assets to pay benefits when due and make comparisons among employers. The Lottery is unable to determine the actuarial present value of credited projected benefits and net assets available for benefits since the information is available only on a total State basis, not agency basis.

The pension benefit obligation at June 30, 1991, for the State system as a whole was \$1,173,852,092. The system's net assets available for benefits at cost on June 30, 1991, were \$919,474,377 leaving an overall unfunded pension benefit obligation of \$254,377,715. The Lottery's 1992 contribution represented approximately .01 percent of total June 30, 1992, contributions required of all participating entities. The Lottery is not responsible for any state system unfunded liability.

Ten-year historical trend information showing the State system's progress in accumulating sufficient assets to pay benefits when due is presented in the system's June 30, 1992, annual financial report. Only the first two years of the required 3-year trend information is available.

Note 6: Deferred Compensation Plan - The Lottery's employees are eligible to participate in the State of Montana's deferred compensation plan. The State of Montana administers the plan by contractual arrangement with Nationwide Insurance.

Note 7: Contractual Arrangements -

- A. **Instant Tickets** - The Lottery has signed agreements to purchase instant game tickets from Dittler Brother, Inc., through March 9, 1993. This contract may be terminated by the Lottery with proper notification.
- B. **Computer Hardware and Software Maintenance** - The Lottery has signed an agreement for computer hardware and software maintenance from Stratus Computer, Inc. for \$5,110 per month.

- C. On-line Vendor - The Lottery has signed a contract with Automated Wagering International Inc., a wholly owned corporation of Video Lottery Technologies Inc. to provide on-line terminals, central computers, and telecommunication network through November 9, 1994. The contract provides for payments to be based on a percentage of weekly sales.

Note 8: Prize Contingencies - Big Spin Jackpot - Certain Big Spin prizes awarded are payable to the winners in annual installments of 17 to 20 years, with the first payment being made by the Lottery. The Lottery has entered into agreements with an insurance company under which purchased annuities will provide payments corresponding to the Lottery's obligation to these prize winners. Because it is the intent of the Lottery that the insurance company will make future installment payments directly to each prize winner, neither the present value of the annuities nor the present value of future payments are reflected in the accompanying financial statements. The Lottery would be liable for such future payments in the amount of \$3,734,559 if the insurance company was to default on their payments.

Note 9: Multi-State Lottery Receivable - As a member of the Multi-State Lottery Association (MUSL) and the Lotto*America/Powerball game, the Lottery is required to contribute to a prize reserve fund maintained by MUSL. This fund is to be used only in the event of an unanticipated prize claim. It is an insurance fund intended to protect the member lotteries against the liability that could result from a system failure at one of the member lotteries. All money paid to this fund, as well as the interest earned on the Lottery's share of the fund, would be returned to the Lottery upon leaving MUSL (assuming that no unanticipated prize claims have been paid).

The Lottery contributes to the reserve fund through the set-aside for prizes. In addition the Lottery was required to contribute for its portion of the reserve fund accumulated since the start of the Multi-State Lottery. The Lottery made this payment in full as of June 1990, through an additional two percent of drawing revenue rather than making a lump sum payment. Payments made to the reserve fund are considered a portion of the prize expense associated with the on-line game.

The unreserved accounts were created by the MUSL Board in July 1990. The purpose of this account was to record interest earned on the prize reserve fund when the prize reserve fund balance is not below the ceiling amount. The amounts in the unreserved accounts can be used as approved by the Board.

As of June 30, 1992, the MUSL prize reserve fund had a balance of \$24,802,045 of which the Montana Lottery's combined reserve and unreserved funds were \$571,823.

Note 10: Lotto*America Prizes and Investments - Prizes awarded to Lotto*America grand prize winners are paid 20 annual installments. The Multi-State Lottery purchases United States Treasury zero coupon bonds to finance the remaining installments of the grand prizes. The bonds are purchased in the name of the Montana State Lottery, but are held at the Multi-State Lottery.

As the bonds mature, the proceeds are forwarded to the Montana State Lottery and distributed to the grand prize winners on the anniversary date of each win.

As of June 30, 1992, Multi-Sate Lottery holds United States Government zero coupon bonds for the Montana State Lottery with a par value of \$57,168,169.

The approximate market value of these same bonds as of June 30, 1992, is \$29,008,008. The Montana State Lottery has five Lotto*America winners as of June 30, 1992. The combined total of future prize payments owed to the winners as of June 30, 1992, is \$57,165,000. The total annual payments due over each of the next five fiscal years is \$3,053,000 per year. The present value of the future prize payments approximate the current market value of the bonds held for the Montana State Lottery.

Note 11: Board of Crime Control Transfers - Recent legislation required the Montana State Lottery to pay 1.6 percent of net revenue each quarter of the current fiscal year to the Board of Crime Control. For subsequent fiscal years, the Montana State Lottery is required to pay 9.1 percent of annual net revenue to the Board of Crime Control. At June 30, 1992, \$20,120 was payable to the Board of Crime Control. For fiscal year 1992, a total of \$89,325 was transferred to the Board of Crime Control.

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Commissioners
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Helena, Montana

**INDEPENDENT AUDITOR'S REPORT ON COMPLIANCE WITH LAWS AND
REGULATIONS BASED ON THE AUDIT OF MONTANA STATE LOTTERY
FINANCIAL STATEMENTS PERFORMED IN ACCORDANCE WITH
GOVERNMENT AUDITING STANDARDS**

We have audited the financial statements of Montana State Lottery as of and for the year ended June 30, 1992, and have issued our report thereon dated September 11, 1992.

We conducted our audit in accordance with generally accepted auditing standards, and Government Auditing Standards, issued by the Comptroller General of the United States. Those standards require that we plan and perform the audit to obtain reasonable assurance about whether the financial statements are free of material misstatement.

Compliance with State and Federal statutes and regulations applicable to the Montana State Lottery is the responsibility of the Lottery's management. As part of obtaining reasonable assurance about whether the financial statements are free of material misstatement, we performed tests of the Montana State Lottery's compliance with certain provisions applicable to State and Federal statutes and regulations. However, it should be noted that our objective was not to provide an opinion on overall compliance with such provisions. Accordingly, we do not express such an opinion.

The results of our tests indicate that, with respect to the items tested, the Montana State Lottery complied, in all material respects, with the provisions referred to in the preceding paragraph. With respect to items not tested nothing came to our attention that caused us to believe that the Montana State Lottery had not complied, in all material respects, with those provisions.

We noted certain immaterial instances of noncompliance that we have reported on the following page.

This report is intended for the information of management and legislative audit committee. This restriction is not intended to limit the distribution of this report, which is a matter of public record.

September 11, 1992

Douglas Wilson & Company, P.C.

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MONTANA STATE LOTTERY

COMPLIANCE FINDING
JUNE 30, 1992

Finding:

During fiscal years 1992 and 1993 the Montana State Lottery sold lottery tickets to the general public at certain fairs and events. The tickets were sold by lottery personnel at special booths during fairs and events held in Billings, Helena, Miles City, Great Falls and Bozeman during fiscal years 1992 and 1993.

According to MCA 23-7-301(1), lottery tickets or chances may be sold only by ticket or chance sales agents licensed by the director in accordance with this section. The Montana State Lottery is not authorized to sell lottery tickets on a retail basis to the general public.

Montana State Lottery Comment:

The Montana Lottery does not believe they were in violation of Section 23-7-301(1), MCA. At each of the fairs and events there was a licensed retailer, e.g. The Montana State Fair, who was paid the commissions for any tickets sold at that location. The staff of the Montana Lottery worked as clerks for the licensed retailer.

Additionally, the Montana Lottery commission approved on September 11, 1992, that the staff of the Lottery will no longer work in this capacity at any fair or other event.

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Commissioners
Montana State Lottery
Helena, Montana

INDEPENDENT AUDITOR'S REPORT ON INTERNAL CONTROL STRUCTURE RELATED MATTERS NOTED IN THE MONTANA STATE LOTTERY FINANCIAL STATEMENT AUDIT CONDUCTED IN ACCORDANCE WITH GOVERNMENT AUDITING STANDARDS

We have audited the financial statements of Montana State Lottery for the year ended June 30, 1992, and have issued our report thereon dated September 11, 1992.

We conducted our audit in accordance with generally accepted auditing standards, and Government Auditing Standards, issued by the Comptroller General of the United States. Those standards require that we plan and perform the audit to obtain reasonable assurance about whether the financial statements are free of material misstatement.

In planning and performing our audit of the financial statements of Montana State Lottery for the year ended June 30, 1992, we considered its internal control structure in order to determine our auditing procedures for the purpose of expressing our opinion on the financial statements and not to provide assurance on the internal control structure.

The management of Montana State Lottery is responsible for establishing and maintaining an internal control structure. In fulfilling this responsibility, estimates and judgments by management are required to assess the expected benefits and related costs of internal control structure policies and procedures. The objectives of an internal control structure are to provide management with reasonable, but not absolute, assurance that assets are safeguarded against loss from unauthorized use or disposition, and that transactions are executed in accordance with management's authorization and recorded properly to permit the preparation of financial statements in accordance with generally accepted accounting principles. Because of inherent limitations in any internal control structure, errors or irregularities may nevertheless occur and not be detected. Also, projection of any evaluation of the structure to future periods is subject to the risk that procedures may become inadequate because of changes in conditions or that the effectiveness of the design and operation of policies and procedures may deteriorate. For the purpose of this report, we have classified the significant internal control structure policies and procedures in the following categories:

1. Cash Receipts/Receivables/Revenue
2. Program Fund Expenditures/Assets/Payables/Expenses
3. Payroll/Related Liabilities
4. Fixed Assets Depreciation/Intangibles Amortization

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For all of the control categories listed above, we obtained an understanding of the design of relevant policies and procedures and whether they have been placed in operation, and we assessed control risk.

We noted certain matters involving the internal control structure and its operation that we consider to be reportable conditions under standards established by the American Institute of Certified Public Accountants. Reportable conditions involve matters coming to our attention relating to significant deficiencies in the design or operation of the internal control structure that, in our judgement, could adversely affect the entity's ability to record, process, summarize and report financial data consistent with the assertions of management in the financial statements. Reportable conditions are listed on page 20.

A material weakness is a reportable condition in which the design or operation of the specific internal control structure elements does not reduce to a relatively low level the risk that errors or irregularities in amounts that would be material in relation to the financial statements being audited may occur and not be detected within a timely period by employees in the normal course of performing their assigned functions.

Our consideration of the internal control structure would not necessarily disclose all matters in the internal control structure that might be reportable conditions and, accordingly, would not necessarily disclose all reportable conditions that are also considered to be a material weakness as defined above. However, we believe none of the reportable conditions described above is a material weakness.

This report is intended for the information of management and legislative audit committee. This restriction is not intended to limit the distribution of this report, which is a matter of public record.

Douglas Wilson & Company, P.C.

September 11, 1992

MONTANA STATE LOTTERY
CURRENT YEAR REPORTABLE CONDITION
JUNE 30, 1992

Reportable Condition:

During our fiscal year 1992 audit, it was brought to our attention by the lottery director that there was a cash shortage from lottery ticket sales at certain special event booths. Specifically, the special events were fairs and rodeo events held in Billings, Bozeman, Great Falls, Helena and Miles City during fiscal years 1992 and 1993. Total reported cash shortages from all events combined was \$2,732. The data from several events was reviewed including the designed control procedures for this type of event. In addition, the operation of the lottery booth at the 1992 State Fair was observed by one of our auditors.

As a result of our review, we found adequate procedures in place so that had they been carefully followed, this would not have occurred. One problem area may have been not placing an Instabuck in the cash drawer each time a customer purchased five lottery tickets and received one free ticket. Without an accurate account of free tickets, there would be a cash shortage on any given day.

Recommendation:

We recommend all involved personnel adhere more carefully to the procedures in place for special events. Additionally, it may be necessary to modify future special event booth operations and ticket promotions to allow for a more accurate daily balancing of ticket sales.

Montana State Lottery Comment:

We concur with your recommendation and reiterate that on September 11, 1992, the Lottery commission approved that the staff of the Lottery will no longer work in this capacity at any fair or other event.

MONTANA STATE LOTTERY
STATUS OF PRIOR AUDIT REPORTABLE
CONDITIONS AND RECOMMENDATIONS
JUNE 30, 1992

Recommendation:

We recommend that the Montana State Lottery develop an accounting policy and procedure manual.

Action (per 6/30/91 report):

The Lottery is actively developing accounting policies and procedures documents to reduce to writing the policies and procedures that are in place. The documents are in different stages of completion.

Status (as of 6/30/92):

The Lottery has put in writing specific accounting procedures that are currently in place. This manual is not complete; however, the Lottery continues to update as time permits.

Current Auditor Comment:

The Lottery has written accounting policies and procedures in many key areas such as year-end ticket inventory procedures, ILS, OLS, accounts payable, and others. There are still some minor policies and procedures that the Lottery must put into writing.

